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SALES TAX HARMONIZATION: DETAILED AGREEMENTS REACHED

Finance Minister Paul Martin and Revenue Minister Jane Stewart today announced the signing of detailed agreements between the Government of Canada and the governments of Nova Scotia, New Brunswick and Newfoundland and Labrador outlining the new harmonized sales tax system which will be implemented in those provinces on April 1, 1997.

Minister Martin and the Ministers of Finance in the participating provinces released a joint technical paper which provides guidelines on how the harmonized sales tax system will operate. The technical paper will form the basis for legislation to be released later this year.

The detailed agreements and the technical paper are based on the principles outlined in Memoranda of Understanding between the federal and provincial governments signed in April of this year.

Broad elements of the final agreements include:

- the replacement of the current federal and provincial sales tax systems with a single combined value-added tax, which will be called the Harmonized Sales Tax (HST);
- a substantial reduction from current combined rates, down to 15 per cent in the three participating provinces;
- a single administration of both federal and provincial sales taxes;
- tax-inclusive pricing so that consumers will know in advance of their purchase the exact price they will pay. For transparency, the tax or rate of tax will be shown separately on the sales slip; and,
- a national approach to interprovincial sales to ensure a level playing field for businesses in the participating provinces.



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Federal rebates and the GST low-income tax credit will continue to apply under the harmonization agreement.

“The HST means a simpler tax system for both consumers and businesses,” said Minister Stewart. “It will also mean more efficient government through reduced overlap and duplication.”

For consumers, it will mean that prices will include the tax -- consumers will know the full price before they get to the cash register. The tax or rate of tax will continue to be shown separately on the sales slip. The federal government will implement tax-inclusive pricing in areas of federal jurisdiction such as airline travel and telecommunications.

Consumers will also benefit from substantially lower tax rates in each province -- effectively almost four percentage points lower in Nova Scotia and New Brunswick, and almost five percentage points lower in Newfoundland and Labrador.

For business, the HST will mean lower costs and less paperwork as there will be only one administrative system, one tax, one base and one rate. There will be no separate requirement to register for the HST. Businesses that are registered for the GST will be automatically registered for the HST. In addition, registrants will continue to use the current GST return to calculate net tax remittances; there will be no need to separately report the federal and provincial components of the HST.

Businesses in the participating provinces will also be more competitive -- both abroad and at home -- because provincial retail sales taxes will no longer be levied on business inputs.

Under harmonization, businesses across Canada will be required to collect and remit the 15-per-cent HST on sales into the three participating provinces. Sales tax on interprovincial sales has always been applicable on a self-assessment basis. The new approach ensures that sales tax is collected and remitted in a more effective manner. This approach will ensure that all businesses selling in the participating provinces will be on a level playing field.

“The bottom line is that the HST will improve the competitiveness of businesses in the participating region and is a positive step towards creating jobs in those provinces,” Minister Martin said.

The Minister added that the federal government will continue to seek agreement with other provinces interested in harmonization.

Background information is attached explaining how the HST will operate. All references in the technical paper to "Announcement Date" should be read as references to today's date. Copies of the technical paper can be obtained by calling the Finance Department Distribution Centre at (613) 943-8665.

Beginning October 24, Revenue Canada will operate a telephone information service for Canadians in the participating provinces who want information about the HST. For residents of Nova Scotia and New Brunswick, the phone line will be open from 8:15 a.m. to 5 p.m. local time. For residents of Newfoundland and Labrador, the phone line will be open from 8:15 a.m. to 5 p.m. Newfoundland time. Following are the toll-free numbers:

- For service in English, call 1-800-959-8286. For service in French, call 1-800-959-3384 (service between 8:15 a.m. and 5 p.m. Atlantic Standard Time). Telecommunications device for the deaf/hearing impaired -- 1-800-665-0354.

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Press release and other materials are also
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SALES TAX HARMONIZATION:

AN OVERVIEW

On April 1, 1997, the current retail sales taxes in Nova Scotia, New Brunswick, and Newfoundland and Labrador and the federal GST in those provinces will be replaced by a single, harmonized value added tax, which will be called the Harmonized Sales Tax (HST).

The HST will apply at a single rate of 15 per cent on the same base of goods and services as the current GST. Seven percentage points will represent the federal component and eight percentage points the provincial component.

- **For Nova Scotia and New Brunswick, this will represent a decrease in the effective sales tax rate of 3.77 percentage points -- from a combined federal-provincial rate of 18.77 per cent to 15 per cent.**
- **In Newfoundland and Labrador, the rate decrease will be 4.84 percentage points -- from a combined federal-provincial rate of 19.84 per cent to 15 per cent.**

The reduction of the tax rate applicable on many goods and the broadening of the tax base at the provincial level will result in a provincial sales tax system that is more equitable in its treatment of goods and services.

Tax-inclusive Pricing

New rules will ensure that consumers are aware of the full price they will have to pay before they make a purchase. Under this approach, vendors will be required to price on a tax-included basis to ensure that consumers are aware of the final price of goods or services before reaching the cash register. For example, a retailer selling a compact disc for \$20 will show the total price including tax, which would be \$23; the retailer can also show the tax-excluded price of \$20 if desired. At the same time, receipts and invoices will show either the amount of tax paid or the rate at which tax has been charged, so that consumers will continue to be aware of how much tax they pay.

The federal government will implement tax-inclusive pricing in areas of federal jurisdiction such as airline travel and telecommunications.

One Base, One Rate, One Set of Rules

A key element of the new system will be a single set of rules and forms, and a single administration. The rules governing the operation of the HST will be set out in the *Excise Tax Act*, and will generally be those rules on which the GST currently operates.

This approach will ensure a smooth transition to the HST, and will maximize the compliance and administrative cost savings from harmonization. As a result:

- **Businesses in participating provinces will now deal with one, rather than two, tax administrations.** The tax will initially be administered by Revenue Canada, with responsibility passing to the proposed border and revenue agency once that body is established.
- **There will be no separate requirement to register for the HST.** Businesses that are registered for the GST will automatically be registered for the HST. Accordingly, they will be required to collect and remit the tax at the harmonized rate of 15 per cent on any taxable supplies they make in the participating provinces. Similarly, businesses engaged in commercial activities that purchase goods and services in participating provinces that are taxed at the harmonized rate will be entitled to recover tax payable at the HST rate of 15 per cent.
- **Registrants will continue to use the current GST return to calculate net tax remittances.** When reporting tax collected and remitted -- and input tax credits claimed -- there will be no need for registrants to separately identify the federal and provincial components of the HST, or tax collected at the 7-per-cent rate.
- **The HST tax base will be the same as the GST tax base.** This means that items such as basic groceries, prescription drugs and medical services will continue to be free of tax.

A More Transparent Sales Tax

Under the current retail sales taxes, businesses pay tax on expenses that they incur in the production of goods and services that they sell. The prices that businesses charge for these goods and services therefore reflect these embedded taxes. A key advantage of the HST for registrants will be the removal of these embedded taxes from the cost of goods and services. This will make the tax payable on goods and services more transparent to consumers. In addition, businesses in the participating provinces will be able to price their goods more competitively. This will be particularly advantageous for exported goods, which will be free of sales tax.

A Level Playing Field

The design of the HST will ensure that goods and services sold into a participating province are subject to the same level of tax as goods or services sold by a business located in the participating province. Businesses across Canada that are registered for the GST will be required to collect and remit the 15-per-cent harmonized tax on goods or services sold into a participating province or shipped to a consumer in that province. For example, a supplier in Ontario who sells goods or services into a participating province will be required to collect the

15 per cent HST. This requirement does not represent a new sales tax on goods or services sold into the participating provinces. Sales tax on interprovincial sales has always been applicable on a self-assessment basis. The new approach ensures that sales tax is collected and remitted in a more effective manner. At the same time, all businesses registered for the GST will be eligible for input tax credits in respect of HST payable on inputs into their commercial activities.

This approach ensures that businesses in the participating provinces are on a level playing field with businesses in non-participating provinces. This approach is also a clear benefit for provinces agreeing to harmonize and to adopt federal legislation, as they will have a more efficient tax collection system that minimizes tax-revenue leakage.

Special rules, which are described in detail in the technical paper, will determine when a supply of a good or service will be considered to be made in a participating province.

Treatment of Books

The federal government will implement a 100 per cent GST rebate on all books purchased by public libraries, schools, universities, public colleges, municipalities and qualifying charities and non-profit organizations across Canada, effective immediately. This will include all classroom books distributed freely to students by educational authorities. The result will be that books purchased by these bodies will not be subject to the federal sales tax anywhere in Canada (including the federal portion of the HST in participating provinces).

Nova Scotia, New Brunswick and Newfoundland and Labrador will provide point-of-sale rebates so that the provincial portion of the HST will not apply to any book sales in those provinces.

Tax Relief for Charities and Public Sector Bodies

The participating provinces will provide rebates for the provincial component of the HST to charities and qualifying non-profit organizations (other than public institutions) in the participating provinces. As under the GST, the rebate rates will be 50 per cent of non-recoverable tax paid.

Under the GST, municipalities, hospitals, schools, public colleges and universities receive a partial rebate. The impact of the HST on the budgets of these bodies will vary depending on the amount of provincial retail sales tax they currently pay, and is affected by factors such as their current tax status, provincial retail sales tax rates and exemptions.

In Newfoundland and Labrador, no rebate of the provincial component of the HST will be offered to these provincial government entities as they will either pay less tax than they do currently and/or they are directly funded by the provincial government.

In New Brunswick, municipalities will be offered a rebate of 57.14 per cent of the non-recoverable tax paid in respect of the provincial component of the HST (the same level of rebate as under the GST).

In Nova Scotia, municipalities, hospitals, schools, colleges and universities will be eligible for rebates at the same level as currently provided for under the GST.

Rebates for Housing and Tourism

The existing GST rebate for housing will continue to apply under the HST. In addition, a rebate will be available to buyers of new homes constructed in Nova Scotia who use the home as their primary place of residence. The amount of the rebate will equal 18.75 per cent of the provincial component of the HST with a maximum rebate of \$2,250. Purchasers of single homes, semi-detached homes, condominium units and co-operative housing units will be eligible for the rebate. The criteria for determining eligibility and procedures for claiming the rebate will generally be the same as those currently in place. Guidelines will be developed for owner-built housing.

Given the importance of the tourism industry to the economies of the three participating provinces, the existing GST rebates for visitors and conventions will apply to the full 15 per cent HST rate.

Next Steps

In the coming months, legislation will be tabled in the House of Commons and in the legislatures of the participating provinces to implement the harmonized tax effective April 1, 1997.

In the meantime, the participating governments will be working with the business community to prepare for the HST. This will include providing further details on administrative aspects of the HST and on transitional measures associated with winding down the existing provincial retail sales taxes.

SALES TAX HARMONIZATION:

WHAT IT MEANS FOR CONSUMERS AND BUSINESSES

For Consumers

Harmonization will mean substantially lower sales tax rates in each of the participating provinces, a simpler sales tax system, and lower prices on most goods.

Harmonization will mean a lower combined rate for consumers: In Nova Scotia and New Brunswick, the combined rate of 15 per cent will be almost four percentage points less than it is now; in Newfoundland and Labrador, almost five percentage points less.

Tax-inclusive pricing will make the sales tax system clearer and simpler: Consumers have expressed a strong preference for a full disclosure of the total tax-included price in advance of their purchases. Under the harmonization agreement, consumers in the participating provinces will know the full price of a good or service before they get to the cash register. At the same time, receipts and invoices will disclose either the amount of tax paid or the rate at which tax has been charged. The rules for tax-inclusive pricing have been designed to minimize business costs and maintain a level playing field for businesses.

Harmonization will mean lower prices on most goods: Prices will fall on most goods because the HST will mean a lower sales tax rate and the elimination of hidden provincial retail sales taxes. Under the current provincial retail sales tax systems, businesses are taxed on the items they buy to make their products, deliver their services and keep their business going. These embedded taxes are passed on to consumers in the form of higher prices.

For goods and services not previously taxed, some prices may go up, but generally by less than the full extent of the provincial portion of the HST. This is because the taxes currently embedded through business inputs will be removed.

Inclusion of services in the harmonized tax base will spread the tax burden more evenly across all sectors of the economy: Taxing services reflects the need for governments to ensure that revenues keep pace with changes in the economy -- services are the fastest growing component of expenditures in Canada. A harmonized sales tax on a broad range of goods and services will also permit governments to keep sales tax rates at a lower level, and ensure a greater degree of fairness in the tax treatment of individuals and families which consume different mixes of goods and services.

For Businesses

Harmonization will lead to a simpler and more efficient tax system for business: One administration, one tax, one base and one rate. It is estimated by the Canadian Institute of Chartered Accountants that, on a national basis, harmonization of all provinces would lead to \$400 million to \$700 million in annual savings for business. Harmonization will be particularly advantageous for small businesses which currently bear disproportionately higher compliance costs to deal with two or more separate sales tax systems on a daily basis.

There will be no separate requirement to register for the HST: Businesses that are registered for the GST will automatically be registered for the HST. Small businesses with \$30,000 or less in taxable sales will have the option of registering for the HST. By registering, they will be eligible for input tax credits on qualifying purchases.

Tax remittances will be made on the current GST return: There will be no need to separately identify the federal and provincial components of the tax collected and remitted at the 15-per-cent rate, or input tax credits claimed at the 15-per-cent rate.

Exports by business will be more competitive: Exports will be free of the hidden sales tax that comes from the provincial retail sales tax on business inputs. For the same reason, goods produced in the participating provinces will also become more competitive against imports.

Harmonization will mean a level playing field for businesses in the participating provinces: Businesses selling into the participating provinces will be required to collect and remit the 15 per cent HST on goods and services sold into the harmonized provinces. Full tax will also apply when the supply of a good or service is considered to be made in a harmonized province. At the same time, all registered businesses will be eligible for input tax credits in respect of HST payable on inputs into their commercial activities. This approach will ensure that all businesses selling in the participating provinces will be on a level playing field. The new system will improve the competitiveness of businesses in the participating provinces and is a positive step towards creating jobs in those provinces.

Harmonization will also minimize distortions in investment decisions associated with the taxation of business investments in capital: Because retail sales taxes are being eliminated, they will no longer influence decisions on capital investments such as computers or machinery and equipment.

SALES TAX HARMONIZATION:

QUESTIONS AND ANSWERS

Tax-inclusive Pricing

Q. Why are you implementing tax-inclusive pricing?

- A. Throughout the government's deliberations on replacing the GST, Canadians have expressed a strong preference for tax-included pricing. Tax-inclusive pricing will benefit consumers who will be able to know the full price of goods and services before they purchase them.

In addition, the House of Commons Finance Committee recommended that tax-inclusive pricing be adopted in moving to a harmonized sales tax.

At the same time, we have consulted extensively with businesses and are sensitive to their concerns. We have developed rules to ensure businesses located in participating provinces are not put at a competitive disadvantage *vis-à-vis* their competitors who do not have to comply with the same rules. These rules will help implement tax-inclusive pricing with minimum expense.

It is important to point out as well that under harmonization, businesses in the participating provinces will no longer pay provincial sales tax on their business inputs. This will significantly reduce the costs of running their business and make them more competitive.

We will continue to work with retailers and businesses to ensure the new tax-inclusive pricing system works effectively and efficiently.

Q. How will consumers know how much tax they will pay if it's included in prices?

- A. The tax will be clearly shown on receipts -- keeping the tax visible. Businesses will also have the option of posting tax-excluded prices as well as tax-included prices.

Q. Why are you allowing businesses to display both tax-in and tax-out prices?

- A. Dual pricing will minimize competitive inequities between businesses located inside and outside the participating region. Dual pricing will also allow businesses to continue to use their existing cash registers and still comply with tax-inclusive pricing requirements. We expect that in the long run businesses will adopt full tax-in pricing when more provinces decide to harmonize.

Q. Will businesses be forced to replace their cash registers to comply with tax-inclusive pricing?

- A. No. Existing cash registers and point of sale systems will be able to accommodate the new pricing requirements and will require only minimal re-programming. As is currently the case, receipts will still have to show either the amount of tax paid or the rate at which tax was applied.

Q. Why is the federal government implementing tax-inclusive pricing in areas of federal jurisdiction?

- A. Consumers across the country, not just those who live in the participating provinces, have clearly demonstrated a strong preference to know with certainty the full price of the goods and services they buy before they actually make a purchase. The federal government represents all Canadians and, to the greatest extent possible, it is acting to respond to consumers' wishes.

Q. How will you enforce tax-inclusive pricing?

- A. The federal and provincial governments will work together to ensure that consumers and businesses are fully informed of the tax-inclusive pricing requirements.

Our initial efforts will focus on educating businesses so they are aware of the requirements and are able to comply with them.

Details regarding the mechanism for monitoring and enforcing these requirements will be made available in the near future.

Treatment of Interprovincial Sales and Imports

Q. Why are you requiring businesses across Canada to participate in the harmonization agreement by forcing them to collect the HST on all sales into the three participating provinces?

- A. This measure will ensure that all businesses selling in the participating provinces compete on a level playing field. It's only fair, for example, that mail-order items from other provinces are taxed at the same rate as purchases made in the participating provinces.

Not only does this make the system fair for business, but it gives the participating provinces a more effective tax collection system by minimizing tax-revenue leakage on interprovincial sales of goods and services.

Q. Is this a new tax on businesses selling into the participating provinces?

- A. Not at all. Retail sales tax has always been applicable on a self-assessment basis. By requiring businesses to collect and remit the HST, we are simply ensuring that sales tax is collected and remitted in a more effective manner. This minimizes tax-revenue leakage on interprovincial sales and helps to keep the tax rate lower.

Q. Will businesses have to track sales and remit the federal and provincial portions of the HST separately?

- A. No. The system will be simpler for businesses because they will have only one sales tax form -- they will use the existing GST form for remitting the tax.

Q. How will imports be treated under the HST?

- A. The 15 per cent HST will apply to most taxable goods and most services imported into the participating provinces by consumers. This treatment ensures that foreign suppliers do not have a competitive advantage over domestic suppliers in the participating provinces.

Q. Will residents of the participating provinces be subject to the HST on goods they bring into Canada?

- A. Yes. Revenue Canada will collect the full HST at 15 per cent on casual goods that residents of the participating provinces import from outside the country. Casual importations are those that are not for sale and do not have any commercial, industrial, occupational, or institutional use. The HST will apply to casual importations no matter how or where they enter the country. For instance, the tax will apply to casual importations that residents of a participating province bring with them into the country, or import through a postal or courier service or by commercial means.

The HST will also apply to all goods that are currently subject to the Goods and Services Tax (GST). It will not apply to goods that are currently exempt from GST and customs duties such as personal exemptions that returning residents can claim.

Economic Impact

Q. Won't harmonization increase the total tax paid by consumers because of the increased tax on items like home heating fuel and clothing?

- A. Past experience has shown that in moving to a value-added tax, the price of goods does not rise by the full extent of the tax. Prices on the vast majority of goods will actually decrease because of the lower combined tax rate and the removal of embedded provincial retail sales tax already included in the price of those goods.

Q. Will businesses pass on their tax savings in the form of lower prices on certain goods?

- A. There is clear evidence to indicate that businesses will pass on tax savings in the form of lower prices in a competitive marketplace. Past studies done in Canada and other countries show that when sales taxes are replaced with value-added taxes, tax savings were passed on to consumers.

The savings come from the fact that provincial retail sales taxes are currently levied on a broad range of business inputs -- the things that businesses buy to make their products and run their operations. Because the hidden tax becomes embedded throughout the production and distribution chain, prices are inflated by several layers of provincial sales tax. The HST will eliminate these hidden taxes by allowing them to claim an "input tax credit" for sales tax paid on their purchases of goods and services used to make their products and run their operations.

Bear in mind as well that competition among businesses is very intense in today's marketplace -- and consumers are always looking for the best bargain. If one business can attract more customers by reducing prices, other businesses will be inclined to follow suit.

Q. What effect will sales tax harmonization have on the underground economy?

- A. Harmonization will help to combat the underground economy by increasing the incentive for businesses to operate within the sales tax system.

Under the new system, businesses which are registered with Revenue Canada will be able to claim an "input tax credit" for sales tax paid on their purchases of goods and services used to make their products and run their operations. Given that input tax credits will be available for the 15-per-cent harmonized tax (as opposed to the 7-per-cent rate now), there is an increased incentive for businesses to comply with the system.

The common tax administration under sales tax harmonization will lead to a more efficient allocation of government resources and will further assist in the government's efforts to fight the underground economy. Moreover, the harmonization agreement provides for a strengthened audit capacity.

Finally, since 1993 the federal and provincial governments have been implementing a comprehensive and successful strategy to combat the underground economy through a variety of measures, including better enforcement.

Impact on Provincial Sales Tax Revenues

Q. How will revenues be shared among the participating provinces?

- A. Revenues will be shared between governments based on final consumption data provided by Statistics Canada.

Exemptions, Rebates and Credits

Q. Why doesn't the federal government remove GST from books completely, instead of providing a rebate for public libraries, schools, universities, public colleges, municipalities and qualifying charities and non-profit organizations?

- A. The federal government is providing the rebate as part of its efforts to promote literacy.

In a time of limited resources, the best way to ensure the biggest impact for every dollar spent is to target assistance to institutions which have the most impact on literacy -- such as public libraries, schools, educational institutions and other front-line literacy groups. The rebate will apply to all books purchased by these organizations, including classroom books distributed freely to students by educational authorities.

In this way the rebate supports the important role played by these organizations in helping individuals, regardless of income, acquire the tools they need to learn how to read or improve their ability to do so.

Q. You have always said that the government could not afford to zero-rate books. If that is the case, where is the money for the GST rebate on books going to come from?

- A. The federal government is committed to promoting literacy and education. However, in a time of limited resources, it is important to target assistance to institutions which have the most impact on literacy. The cost of the GST rebate on books will be approximately \$25 million. This investment will be financed from within the existing fiscal framework without jeopardizing the government's deficit targets.

Q. What happens to the GST low-income credit?

- A. The federal government will continue to provide \$2.7 billion a year under the credit to qualifying low-income individuals and families.

Administering the Tax

Q. Who will administer the tax?

- A. Revenue Canada will initially administer the HST in the three provinces. Once established, the proposed border and revenue agency will administer the HST.

Q. What will happen to provincial revenue employees?

- A. Revenue Canada has made every effort to offer employment to provincial tax administration staff, while respecting the objective of streamlining the administration of taxes.

In the transition period following the introduction of the tax, Revenue Canada will hire up to 70 officials from each of the three provinces to support the ongoing administration of the harmonized sales tax.

Q. How much will it cost to administer the HST?

- A. Streamlining two levels of sales tax administration will reduce overlap and duplication. This will make government more efficient and result in significant savings. Early estimates indicate future savings of about \$10 million annually from salaries and other related administrative costs.

Once the tax is fully implemented, we will review the ongoing resource requirements. And, since Revenue Canada's total number of staff will increase with the addition of provincial staff, the department can direct resources into program areas such as client assistance, audit, and combating the underground economy. This will help reduce accounts receivable and increase compliance rates. This, in turn, will make the tax system more efficient and effective.

Q. How will Revenue Canada make sure it maintains service levels in the provinces?

- A. The federal government shares the provinces' interest in maintaining a high level of service in each of the participating provinces. Revenue Canada already has a presence in most locations with provincial offices. However, the department will also establish a presence in Corner Brook, Grand Falls-Windsor, and Clarenville in Newfoundland, and Fredericton, New Brunswick. The department will offer walk-in service at these sites for clients who have questions about their taxes or who want to pay taxes. There will also be auditors on staff to support the department's enforcement efforts.

As well, where appropriate, Revenue Canada will employ people in other communities in a telework arrangement.

Q. How will Revenue Canada and the provinces be accountable to each other?

- A. A Federal-Provincial Tax Administration Liaison Committee will be established to facilitate ongoing federal-provincial co-operation and partnership in administering the HST. Committee members will identify and examine issues, review results, and reach consensus on policies and procedures related to Revenue Canada's administration of the tax.

In addition, Revenue Canada will regularly provide information to the provinces on the administration of the tax, as outlined in agreements on the exchange of information and mutual assistance.

For more detailed information, Revenue Canada has produced a fact sheet entitled *Sales Tax Harmonization: Federal-Provincial Liaison and Information*.

Q. How will harmonization affect the tax centre in Summerside, Prince Edward Island?

- A. The effect will be minimal. The Summerside Tax Centre now processes GST returns and payments for all of Canada including the Atlantic provinces. The HST will be collected on the same base and in generally the same way as the current GST. This allows Revenue Canada to use the same processes it already has in place for the GST.

